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July 7, 1997

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BY HAND DELIVERY

William Caton
Office of the Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: Reply Comments of SBC Communications Inc. on Ameritech Michigan's Section 271 Application — CC Docket No. 97-137

Dear Mr. Caton:

Please find enclosed for filing the original together with twelve copies of SBC's Reply Comments in the above-captioned matter. We are also enclosing an electronic version in WordPerfect 5.1 format.

Please stamp and return the extra copy to the messenger.

Sincerely,

Michael K. Kellogg

Michael K. Kellogg

Enclosures

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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of 1996 to Provide In-Region, InterLATA Services in Michigan	CC Docket No. 97-137

To: The Commission

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

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July 7, 1997

EXECUTIVE SUMMARY

In commenting upon the application of Ameritech Michigan for interLATA relief in that State, the Department of Justice has compounded the legal errors evident in its assessment of SBC's application for interLATA authority in Oklahoma. The Department evidently believes that by going beyond the antitrust area where Congress intended it to advise the Commission, it can leverage a purely consultative role under section 271(d)(2) into de facto regulatory authority over the Bell companies. Then, as if to confirm Congress's judgment that it should not have such authority, the Department endorses policies that — however vaguely defined — would violate the Communications Act and could have a devastating impact on facilities-based local competition and network investment.

Specifically, the Department has adopted the "metric" approach Congress definitively rejected. It also has urged the Commission to accept additional preconditions for interLATA relief that would expand the fourteen requirements of the competitive checklist, which is forbidden to the Commission by section 271(c)(4). Finally, the Department has raised an issue regarding access to the "network platform." If the Department means to endorse the ordering and pricing demands made by interexchange carriers, it would wipe out the Act's important distinction between resale and network unbundling, render the statutory discount for resale moot, and eliminate any incentive for new entrants to build local facilities.

This Commission should reject the Department's recommendation and reaffirm that satisfaction of section 271(d)(3)'s prerequisites, not accommodating the Department's misguided policy preferences, is the requirement for interLATA relief.

TABLE OF CONTENTS

REPLY COMMENTS OF SBC COMMUNICATIONS INC.

These Reply Comments address an issue that cuts across all section 271 proceedings: the proper role of the U.S. Department of Justice. As SBC explained in briefing its own application to provide in-region, interLATA services in Oklahoma, and as is further detailed below, the Department fundamentally misconceives its place in the section 271 process. This Commission should not acquiesce in that mistake in the interests of comity, but rather should faithfully carry out its own responsibilities notwithstanding the Department's misguided urging to do otherwise.

I. BECAUSE THE DEPARTMENT HAS EXCEEDED ITS PROPER STATUTORY ROLE, ITS EVALUATION IS DUE NO SPECIAL DEFERENCE

Congress decided what was necessary and sufficient for Bell companies to be found to have opened their local markets; its conclusions are found in new section 271(c) of the Communications Act. That section requires a Bell company to demonstrate that its local telephone markets are open to competitors either through actual interconnection agreements with specific facilities-based carriers, or through a statement of the terms and conditions that the Bell company offers to all competitors generally. Either way, the Bell company must demonstrate that it makes available all fourteen items of the competitive checklist. See 47 U.S.C. § 271(d)(3)(A).[1] The checklist is Congress's test for when markets are sufficiently open. Section 271(d)(4) thus provides that the FCC "may not, by rule or otherwise, limit or extend the

[1] SBC has presented in the United States District Court for the Northern District of Texas its arguments that section 271 contravenes separation of powers principles, is unconstitutional as a bill of attainder, and violates equal protection guarantees. Here we focus on the narrower issue of applying section 271 pending a judicial determination regarding its constitutionality.

terms used in the competitive checklist," thereby preventing the Commission from imposing additional preconditions either directly or indirectly.

It was only with respect to the effect of Bell company entry on long distance competition that Congress provided a role for the Department of Justice. The House Bill instructed "the Attorney General [to] provide to the Commission an evaluation of whether there is a dangerous probability that the Bell operating company or its affiliates would successfully use market power to substantially impede competition in the market such company seeks to enter." H.R. 1555 § 101(a) (proposing new 47 U.S.C. § 245(c)(3)). While the Senate Bill allowed the Attorney General more flexibility — allowing her to "apply any appropriate standard," S.652 § 221 (proposing new 47 U.S.C. § 255(c)(2)(A)) — the Senate nonetheless had in mind an antitrust standard similar to that envisioned by the House: "The Attorney General may analyze a Bell operating company application under any legal standard (including the Clayton Act, Sherman Act, other antitrust laws, section VIII(c) of the MFJ, Robinson-Patman Act or any other standard)." S. Rep. No. 104-23, at 43 (1995).

The final Conference Report similarly indicates that, although the Department is free to choose a standard, the focus of its analysis should be the competitive effects of Bell company interLATA entry. The Conference Report even offers specific examples of antitrust standards that would be appropriate, "including: (1) the standard included in the House amendment, whether there is a dangerous probability that the BOC or its affiliates would successfully use market power to substantially impede competition in the market such company seeks to enter; [or] (2) the standard contained in section VIII(C) of the AT&T Consent Decree, whether there is no substantial possibility that the BOC or its affiliates could use monopoly power to impede competition in the market such company seeks to enter." S. Conf. Rep. No. 104-230, at 149 (1996).

In the final days before enactment, legislators confirmed that, under the conference agreement, "the Department of Justice will apply any antitrust standard it considers appropriate,"[2] and that the "substantial weight" to be accorded to the views of the Department is limited to its "expertise in antitrust matters."[3] The Department's discretion thus extends to selecting an antitrust standard and evaluating the competitive effects of Bell company entry into the long distance market under that standard.

Operating within these limits, the Department has previously stated that Bell company interLATA entry will promote long distance competition and, in that respect, serve the public interest. It explained: "InterLATA markets remain highly concentrated and imperfectly competitive, . . . and it is reasonable to conclude that additional entry, particularly by firms with the competitive assets of the BOCs, is likely to provide additional competitive benefits." Evaluation of the United States Department of Justice at 3-4, Application of SBC Communications Inc., CC Dkt. No. 97-121 (filed May 16, 1997). The Department's economic expert similarly notes the "efficiencies from jointly providing local and long-distance services"

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[2] 142 Cong. Rec. H1157 (statement of Sen. Hyde) (daily ed. Feb. 1, 1996) (emphasis added).

[3] 142 Cong. Rec. H1176 (daily ed. Feb. 1, 1996) (statement of Rep. Jackson-Lee); 142 Cong. Rec. H1178 (daily ed. Feb. 1, 1996) (statement of Rep. Sensenbrenner) ("FCC's reliance on the Justice Department is limited to antitrust related matters").

including "on the supply side, the cost savings from joint retailing of services" and "on the demand side, the value to consumers of one-stop shopping and other new integrated services." Affidavit of Marius Schwartz ¶ 83 (May 14, 1997) (attached as Exhibit 1 to the Evaluation of United States Department of Justice, Application of Ameritech Michigan, CC Dkt. No. 97-137 (filed June 5, 1997) ("DOJ Evaluation")). The Department neither questions that competitive safeguards suffice to prevent cost misallocation and discrimination by Bell companies in long distance markets, nor argues that greater local competition is needed to prevent such anticompetitive conduct. To the contrary, its expert explains that "the scope for a BOC, after allowed interLATA entry, to degrade existing access arrangements used by IXCs is relatively limited" even during the period while local competition is developing. Id. ¶ 140.

On such matters, the Department's experience as a party to the MFJ may give it special expertise. But when the Department ventures into implementation of the local competition provisions of the 1996 Act, its views are entitled to no special weight.

II. THE DEPARTMENT RECOMMENDS THE "METRIC" APPROACH CONGRESS REJECTED

The Department opposes Ameritech Michigan's application based not on antitrust concerns, but rather upon its interpretation — and extension — of the competitive checklist. Under the Department's test, it is not enough that a Bell company has satisfied the competitive checklist as set out by Congress and interpreted by the FCC and the relevant state commission. Nor is it sufficient that the Bell company will comply with the safeguards of section 272 and that its interLATA entry would augment long distance competition without causing offsetting competitive harm. Rather, in the Department's misguided view, a Bell company should not be permitted to sell long distance unless it also has met an additional requirement of showing that its local markets "have been fully and irreversibly opened." DOJ Evaluation at 29.

This open-ended test apparently requires, in the first instance, an examination of the Bell company's loss of local market share. And the loss must be substantial to satisfy the Department. Even though competitors serve between 70,000 and 80,000 lines in Michigan — the equivalent of every household in Grand Rapids — the Department wants Ameritech to lose even more customers to show "that no barriers to entry exist." DOJ Evaluation at 31-33. If Ameritech "fails" this market-share test by successfully retaining its local customers in the face of competition, it must then satisfy any and all criteria that the Department wishes to establish to show that competitors face no "obstacles." Id. at 33-34.

It should go without saying that, if embraced by this Commission, the Department's approach would expand the competitive checklist in violation of section 271(d)(4). The Department has simply layered its own test of when local markets are sufficiently and "irreversibly" open on top of that prescribed by Congress.

Worse yet, by seeking to place a heightened burden on Ameritech Michigan because it has not lost more local customers, the Department seeks to reintroduce the "metric" approach Congress specifically rejected. Legislators determined that if local markets are open, the consumer benefits of opening interLATA markets should not be delayed even if local competition fails to materialize. For example, Senator Hollings abandoned his idea of an "actual and demonstrable competition" requirement after he determined that it "was not going to go anywhere."[4] Likewise, the Senate defeated Senator Kerrey's proposal that section 271(c)(1) be changed to provide that "a Bell operating company may provide interLATA services in accordance with this section only if that company has reached interconnection agreements under section 251 . . . with telecommunications carriers capable of providing a substantial number of business and residential customers with" service.[5] The House similarly rejected an amendment that would have required competitors to offer local service to 10 percent of customers as a prerequisite to Bell company interLATA entry.[6]

In the end, Congress relied upon the checklist as a compromise between standards that focused on competitors' entry decisions and the Bell companies' original proposal of interLATA entry on a date certain. The idea, Chairman Pressler explained, was "to find a way in this complex telecommunications arena to have a test of when markets are open."[7] Congress then added section 271(d)(4) as a sort of exclamation point to emphasize the finality of its choice. While the Department may be free under the statute to ignore that choice, its freedom only emphasizes that the Department has no decision-making power. This Commission does have that power, its decision-making must be exercised consistent with statutory constraints.

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[4] 141 Cong. Rec. S8009 (daily ed. June 8, 1995) (statement of Sen. Hollings).

[5] 141 Cong. Rec. S8319, S8326 (daily ed. June 14, 1995).

[6] See 141 Cong. Rec. H8454 (daily ed. Aug. 4, 1995) (statement of Rep. Bunn).

[7] 141 Cong. Rec. S8195 (daily ed. June 12, 1995) (statement of Sen. Pressler); see 141 Cong. Rec. S8009 (daily ed. June 8, 1995) (statement of Sen. Hollings) (discussing abandonment of "actual and demonstrable competition" approach in favor of checklist).

III. THE COMMISSION SHOULD REJECT THE DEPARTMENT'S STANDARDS FOR LOCAL COMPETITION AND PRESERVE CONGRESS'S DISTINCTION BETWEEN RESALE AND NETWORK UNBUNDLING

The Department does not list all the additional requirements it intends to impose where its metric test is not satisfied. This itself is a deficiency in the Department's approach: If the Department wants the Bell companies to satisfy its notion of what section 271 requires, then the Department must spell out its test. This Commission likewise should comprehensively articulate all the standards it will use in applying the checklist, not strategically delay Bell company compliance by withholding its views on critical issues until a later day.

It is clear, however, that the Department's extra-statutory requirements include a mandate that the Bell company must adopt detailed "performance benchmarks" and service-quality reporting procedures that are not required by the Act or this Commission's rules. DOJ Evaluation at 38-40. These requirements appear impossible for a Bell company to meet when there is not <u>substantial</u> demand for its network elements from operational local competitors. That much already was evident from the Department's comments on SBC's application for interLATA relief in Oklahoma.

In commenting on Ameritech Michigan's application, however, the Department has additionally endorsed the "network platform" as "an important entry vehicle for several potential competitors." DOJ Evaluation at 34-35; <u>see also</u> <u>id.</u> at 14-15. The concept of a "network platform" appears nowhere in the 1996 Act or its legislative history; rather, it is a creation of AT&T and other potential local competitors. If, however, the Department means that local competitors should be able to order unbundled network elements ("UNEs") for use with their own telecommunications facilities in the technically feasible combinations they desire, SBC has no objection to the Department's suggestion. Subject to the outcome of its pending appeal before the Eighth Circuit and state proceedings, SBC even will allow competitors to order and use solely recombined network elements to compete against SBC.[8] SBC thus already makes the "network platform" available to competitors.

The major interexchange carriers and other parties such as LCI, however, have attempted (in the guise of addressing access to the "platform") to secure entitlements beyond the right to recombine UNEs. They want incumbent LECs to take an order for an "end-to-end" retail service and then identify, assemble, and supply the combination of network elements that precisely replicates the retail service, at a discount two or three times greater than the resale discount established in accordance with the 1996 Act. If the Department accepts this view, its Evaluation shows a profound disregard for the Act and for sound economic policy.

AT&T in particular has argued in state and federal proceedings that it should be able to order the UNE combinations that constitute the "platform" by simply naming the retail service(s) used by a customer, without ever identifying the specific UNEs needed to provide the "as-is" service. There is no support for this position in the 1996 Act or the Commission's rules. SBC, for instance, has complied with the Act by configuring its operations support systems ("OSSs")

[8] See First Report and Order, Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 15,499, 15,669, ¶ 335 ("Local Interconnection Order"), modified on reconsideration, 11 FCC Rcd 13,042 (1996), petition for review pending sub nom., Iowa Utils. Bd. v. FCC, 96-3321 (8th Cir. filed Sept. 6, 1996); partial stay granted, 109 F.3d 418 (8th Cir. 1996).

to process orders for UNEs separately from orders for retail services. This approach is consistent with the FCC's requirement that UNEs be offered separately, for a separate charge, 47 C.F.R. § 51.307(d), as well as the requirement that "an incumbent LEC must provide, upon request, nondiscriminatory access to operations support systems functions for pre-ordering, ordering, provisioning, maintenance and repair, and billing of [UNEs] under section 251(c)(3) and resold services under section 251(c)(4)." Local Interconnection Order, 11 FCC Rcd at 15,767, ¶ 525.

SBC and the other Bell companies are not required to bear the burden, expense, and liability of translating CLECs' ultimate service objectives into UNE orders, when competitors can obtain the necessary information by using the appropriate OSS function. Rather, as the Commission specifically found, "requesting carriers must specify to incumbent LECs the network elements they seek before they can obtain such elements on an unbundled basis." Id. at 15,649, ¶ 297 (emphasis added). This reflects that where UNEs are combined with the competitor's existing facilities, as Congress intended, only the requesting carrier knows the capabilities of its own network and how the UNEs will be used. That carrier must assume responsibility for its order. While SBC will work with its local competitors to assist them in identifying the elements they need, id., competitors properly determine their own UNE orders and place them through the appropriate OSSs.

The legislative history of section 251 confirms that Congress intended competitors' use of UNEs to be entirely distinct from their resale of the incumbent's end-to-end, retail services. Congress "recognize[d] that it is unlikely that competitors will have a fully redundant network in place when they initially offer local service," as well as that competitors may need initially to obtain "some facilities and capabilities" from the incumbent LEC. S. Conf. Rep. 104-230, at 148. Accordingly, the Act establishes two (and only two) separate and distinct avenues by which competitors may obtain these network facilities or services, with a separate pricing rule for each. First, competitors may purchase unbundled facilities. 47 U.S.C. § 251(c)(3). UNE prices must be "based on the cost . . . of providing the . . . network element," and they "may include a reasonable profit." Id. § 252(d)(1). Alternatively, competitors may purchase "any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers." Wholesale rates for these resold services are determined based upon the retail rate less costs (such as marketing, billing, and collection) that will be avoided by the incumbent LEC. Id. §§ 251(c)(4)(A), 252(d)(3).

Congress made a clear choice that facilities-based competition and resale of retail services should not be treated interchangeably. In the House bill, they had been: that bill imposed a duty to offer "services, elements, features, functions, and capabilities" either on an unbundled basis or "for resale at wholesale rates." H.R.1555 § 101(a) (proposing 47 U.S.C. § 242(a)(2), (3)). Where the resale option was chosen, the wholesale rate would be determined by deducting avoided costs from retail rates. Id. (proposing new 47 U.S.C. § 242(a)(3)).

The Senate bill imposed separate duties on incumbent LECs to provide access to "the network functions and services of the . . . network" and to "telecommunications facilities and information." S.652 § 101(a) (proposing new 47 U.S.C. § 251(b)(1), (2)). "[T]elecommunications services and network functions" had to be provided "without any unreasonable conditions on the resale or sharing of those services or functions," id. (proposing new 47 U.S.C. § 251(b)(7)), but no similar obligation to permit resale was imposed on unbundling of facilities. Pricing of both facilities and services under the Senate bill was to be based on cost, and could include a reasonable profit. Id. (proposing new 47 U.S.C. § 251(d)(6)).

The House/Senate conference committee expanded upon the Senate bill's incipient distinction between unbundled "facilities" and resold "services" and established a different pricing rule for each. The Senate's "cost-plus" pricing approach was used for UNEs, while the House's wholesale pricing approach was used for resold services. Under this approach, new entrants can obtain pieces of the incumbent's network for use in combination with their own facilities at cost-based rates. This reduces the sunk costs of entering the local telephone business on a facilities basis and lowers economic barriers to entry. See Local Interconnection Order, 11 FCC Rcd at 15,508-09, ¶¶ 11-12 (cost-based prices "enable the entrants to share the economic benefits" of incumbents' established networks and allows gradual deployment of self-provided facilities). But competitors have no right to obtain end-to-end services at cost-based rates merely to arbitrage regulatory pricing distortions (such as policies that keep business rates artificially high). See H. Rep. 104-204, pt. 1 at 72 (1995) (wholesale prices should be set to preserve "pricing structures for telephone exchange service in the State").

Congress envisioned that UNEs would be purchased, as an interim measure, by carriers seeking to fill in the pieces of "a fully redundant network." S. Conf. Rep. 104-230, at 148. If a competitor is unwilling to invest in local facilities of its own, and thus foregoes any possibility of developing superior services, it must take services for resale and beat out the incumbent by performing marketing, billing, and collection functions more efficiently (i.e., for less than the amount of the wholesale discount). Congress did not want new entrants to earn profits by undermining universal service cost-recovery mechanisms and other regulatory pricing policies.[9]

By conflating service resale with recombination of UNEs, the interexchange carriers seek to evade the 1996 Act's pricing rules for resale of end-to-end services. The issue is starkly presented in the seven states served by SBC's three incumbent LECs (Southwestern Bell Telephone Company, Pacific Bell, and Nevada Bell). Applying the statute's avoided-cost methodology to their own local markets, these states have adopted resale discounts of between 14.5% (in Arkansas) and 21.6% (in Texas). These resale discounts give competitors a chance to earn profits by outperforming SBC in the areas of marketing, billing, and collection, but preserve their incentive to earn even bigger profits by operating a network that is more efficient, or allows higher-quality services, than SBC's.

That incentive would disappear if, as the major interexchange carriers have suggested and some state commissions have held, a carrier could pay cost-based rates for an end-to-end retail service — merely by calling that service part of the UNE "platform." Consider a competitor in Texas. Under the Act, it could construct its own network (supplemented as necessary by UNEs, such as switches or loops, obtained from Southwestern Bell Telephone Company). The carrier would incur the risk of having built some new facilities, but also would be able to earn sizeable

[9] Likewise, under section 271(e)(1), the major interexchange carriers may not unfairly exploit the Act's restriction on in-region, interLATA services through resale. In order to bundle local and long distance services, they must invest in facilities used to provide telecommunications services, and may not simply repackage the incumbent Bell company's retail services.

profits if its network operations are more efficient than Southwestern Bell's. Alternatively, the competitor could purchase Southwestern Bell's retail services for resale at the 21.6% discount set by the Texas Public Utility Commission and earn its profits through superior marketing, billing, collection, and customer service.

If the carrier could instead order the equivalent of an end-to-end retail service at UNE rates, it would pay cost-based UNE rates instead of the resale rate, while simultaneously avoiding paying access charges that contribute to recovery of Southwestern Bell's overall network costs. See Local Interconnection Order, 11 FCC Rcd at 15,682, ¶ 363, 15,982, ¶ 980. The competitor also would collect the subscriber line charge and obtain any vertical services associated with the end-to-end retail service at no cost, all without constructing any facilities. The result in Texas would be an effective discount of about 55% off the retail rate for business services and 45% off the retail rate for residential services when the carrier orders an end-to-end service in the form of UNEs. The competitor could be vastly less efficient than Southwestern Bell in every aspect of its operations, and still undercut Southwestern Bell's (and resellers') rates — without investing a penny in building a rival local network. See S. Conf. Rep. No. 104-230, at 1 (Act intended "to accelerate rapidly private sector deployment of advanced telecommunications and information technologies").

The resale option established by Congress would be a nullity. Nor would competitors construct new facilities if they could resell end-to-end services obtained at a discount several times larger than what Congress intended. Incumbents, who would be forced to provide competitors their retail services at these inflated discounts, likewise would not invest in new facilities from which they could not earn a fair return.

None of this is speculation. In an "AT&T Investment Community Meeting" held on March 3 of this year, AT&T's General Counsel John Zeglis explained how his company intends to use the "unbundled network element platform" to get around statutory limits on the resale discount. Using Pennsylvania as an example, Mr. Zeglis indicated that the resale discount is 25.9%. But, he said, AT&T had found "[a]nother way to resell": "We're going to buy all the elements, recombine them to make a global service out of the elements." Id., Tr. at 4, 5 (attached hereto). Under this approach, AT&T calculates that it can achieve "a discount of 52 percent" for a Pennsylvania customer that buys $25 of long distance and $5 of intraLATA toll service per month, and "a 64 percent discount" for a customer who uses $75 of long distance and $5 of intraLATA toll per month, as compared to the 25.9% resale discount set in accordance with the 1996 Act. Id. at 5-6.

It is hard to imagine that any incumbent LEC could maintain its rates and services, much less finance network upgrades and develop new offerings, if it were required to sell its finished services to competitors at a wholesale discount of between 52 and 64%. Just as important, there is no provision in the Act that would allow competitors to obtain discounts of this magnitude on what amounts to the equivalent of a resold service -- i.e., an "as is," end-to-end conversion that includes no facilities of the competitor which are necessary to provide the telecommunications service.[10] Congress intended that the resale discount would apply under these circumstances, and nothing in the Department's Evaluation suggests it would endorse a different result.

It is unclear whether, when discussing access to the "platform," the Department intended to embrace the additional pricing and ordering demands of AT&T and the other interexchange carriers. But regardless of the Department's views, this Commission should hold to Congress's clear distinction between resale and network unbundling. The view of AT&T's General Counsel notwithstanding, access to UNEs is not "[a]nother way to resell." If new entrants prefer to provide their customers the incumbent's end-to-end retail services, instead of self-providing the facilities (such as loops, switches, and trunks) needed to carry local calls, that is their choice. But this Commission must recognize that their choice is to be resellers. Local competitors may obtain the incumbent's retail services at the resale discount set by the appropriate state in accordance with section 252(d)(3). They may not, however, circumvent congressional policy (and the role of the state commissions) by confusing UNEs with retail service resale in section 271 proceedings.

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[10]In its Local Interconnection Order, the Commission indicated that the sort of end-to-end unbundling sought by AT&T and others is not properly equated with resale, because purchasing UNEs entails greater risk. Id. At 15,668, 334. One of the champions of the "platform" concept now argues, however, that "there is typically no basis for distinguishing between resale and access to unbundled network elements" because in both cases the incumbent LEC "retains physical control over its network." Petition of MCI for Declaratory Ruling at 7, Dkt. No. 96-98, DA No. 97-557(filed Mar. 11, 1997). As noted above, AT&T also considers end-to-end unbundling "[a]nother way to resell." Id. at 4. Furthermore, to the extent the Local Interconnection Order touched upon the issues addressed here, there was at that time no concrete evidence of the pricing consequences that would follow from a "platform" approach.

CONCLUSION

The Department does not question that long distance consumers would benefit from Ameritech Michigan's provision of interLATA services. Yet it opposes Ameritech Michigan's entry without offering any concrete, countervailing evidence of a benefit from delay, let alone evidence that such benefits would outweigh the significant consumer losses that are sure to occur. In short, the Department's approach is as unwise as it is unlawful.

If the Department had provided the antitrust analysis requested of it, its opinion would be entitled to "substantial weight" under section 271(d)(2). Instead, the Department chose to provide advice this Commission is powerless to accept. Although the Department seems to believe that local markets will not be "irreversibly opened" until competitors are present in sufficient size and scope, Congress decided otherwise. To accept the Department's recommendations would directly violate the Act by extending — indeed, supplanting — Congress's competitive checklist.

Respectfully submitted,

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July 7, 1997

AT&T Investment Community Meeting

Transcript
March 3, 1997 - A.M Session

JOHN ZEGLIS : Okay. Thank you, John. The subject is public policy. Like it or not, public policy still plays a very large role in AT&T's current operations and particularly its future aspirations. That's pretty much a function of where we've come from as a regulated utility. It's almost equally a function of where we want to go into regulated monopoly markets. It means we've had to seek a lot of change in the public policy arena. And my purpose here this morning is to persuade you that our program for this public policy work is not nearly as helter skelter as the briefs and the counter briefs, charges and counter charges may make you think on a daily basis. We have structured our initiatives in the public policy arena around these four central strategic objectives. Number one, we need to eliminate the unnecessary regulation of AT&T. That means there has been too much of it and it's been lopsided against us and in favor of our competitors. Number two, we need to open monopoly markets to new entry. That means the local exchanges in the United States and just about any other country outside this nation.

Number three, until we get those markets open, we need to enforce monopoly safeguards. The most celebrated here is clearly the MSJ like safeguard in the United States, no RBOC long-distance entry until their markets are competitive.

And then the fourth goal, also until we get those monopoly markets made competitive, is to use public policy to bring down this expensive 15 dollar carrier-to-carrier payment bill that we lug around. We call that access domestically and international settlements globally.

So the modus operandi for this talk is to look at those four objectives. We'll do all of them domestically first. We'll double back and do them internationally at the end.

We're going to talk about where we stand today, where we're going to go, what are the big plays this year and next, and in the end what kind of market framework can we deliver to AT&T for us to execute on our strategy.

All right. Number 1, deregulation of AT&T. This is the most fun because it's essentially done. We have had to seek this relief at two levels, state and federal. State as a practical matter we were done with long-distance regulation of our prices and earnings by district of Columbia has a discount rate of 31.4 percent.

Quickly into GTE territory we've got another story going here. We have 52 percent of GTE lines where we've litigated in that discount range. 44 percent of the time we're out of it. That's about 7 million lines. If you live in California, Florida, Oklahoma, Ohio, you ought to be embarrassed.

Another way to resell, and one that figures prominently in our plans, is what we've been calling the unbundled network element. And here if anything we've got a better story coming out of the arbitration. First, everybody who has addressed the issue everywhere is giving us the full unbundling that the FCC called for in its August interconnect order. That means we can get at the elements, at the features and the functions and the ILEC network piecemeal. That includes the vertical features of the switch. We can pick and choose what we need.

Second piece of real good news. Not only can we have them individually, we can buy the elements, put them all back together, create local service out of it, something we call the unbundled network element platform, Uni P. If you can remember that we'll speed up the presentation. But 92 percent of the lines coming out of these arbitrations are eligible for recombination in the way I described, and we will be appealing intensely Georgia, Tennessee, Louisiana and Alabama, where it is not permitted. Nice work Bell South, but you're going to get reversed.

All right. Next issue, what price for these unbundled elements? Well, more good news. Most of the decisions have come out in favor of a pricing methodology that uses long-run incremental forward looking costs. There are a few hybrids in the mix, but the nice part of this is no decision uses the embedded backward looking costs to price these network elements. Again, how are we doing? RBOCs first. We have 94 percent of the RBOC arbitrated lines covered by that forward looking cost methodology, and when you put that methodology onto the costs and the elements in the RBOC territory, it turns out that something like 74 percent of the prices -- this is loop prices -- come out near or below what the FCC estimated would be the case when it issued its August order. These are called proxy prices and they were guesstimates based upon what the forward looking cost methodology would produce. Better pause and acknowledge the national champion, Illinois. 43 percent of the FCC loop proxy. You can get a loop in downtown Chicago for $3.72 a month.

Again, GTE, a little different, this is kind of an amazing story. We have 81 percent of those GTE lines have been arbitrated to use the forward looking cost methodology. Let's put that cost methodology on the actual cost, going forward, and what do we get? Wow. Only 28 percent of the lines fall within that FCC proxy projection, something like 60 odd percent of the lines are outside it, makes you wonder whether they really are high cost. Also going to have to do something about some attempts to put non-recurring charges on us when we win customers in this manner. Those aren't cost based and we're in the process early this year of litigating any such charges back to cost.

Good news I guess is that the business case for using this unbundled platform is going to turn out to be a lot less sensitive to the pricing results than TSR. And that's where I want to move next. I would like to line up for you the economics of TSR on the one hand and unbundled network elements on the other hand in AT&T's strategy and business case.

We're going to start in the state of Pennsylvania, where like other places, TSR margins are modest. This is a good state for us. This is one where our wholesale discount is 25.9 percent. And when you stack the revenue next to the cost, you see that for a consumer averaging 20 dollars of local exchange service in Pennsylvania, we have a cost of goods sold of $14.81. Gives you a chance to market a combined local and long-distance package to this customer, gives you a fighting chance perhaps of recovering your marketing and billing and customer care costs incrementally to what you're already doing for long-distance. But it's tight. I guess what you say is it's a lot better than it used to be in Rochester where on that trial we have began to a five percent discount and the pink stack would have been 19 bucks.

But now let's look at the unbundled network element platform in the same state. We'll stay in Pennsylvania. Admit it's a good state for us. We're going to go into a high density, low Uni price zone. We're going to buy all the elements, recombine them to make global service out of the elements and assume we're doing this to a consumer that buys $25 of long-distance and five dollars of local toll service per month. And now what we end up with, stacked next to it, is quite a different picture. Our cost of goods sold on that platform is $16.03, slightly above the TSR cost. But our revenue is $33.50. Consisting of that same 20 dollars in local that we collect and $3.50 in the interstate subscriber line charge, which under FCC rule comes to the provider under the platform, and 10 dollars worth of access, which was otherwise being paid to the local carrier on the 30 dollars of toll this customer was using. So we have widened our margin on the Uni P by more than twelve bucks over what we had on the TSR side.

Where this company assigns this margin, how you assess this business opportunity, depends upon what business you think we're in at AT&T. If you're a division that thinks your business is local exchange service, that is, you're after the 20 dollars, then you say, wow, I've got an all in, net cost of service that is defrayed by that extra revenue I collected, taking that away from the 16 dollars, I'm not paying more than 2 and a half dollars all in for the cost of goods sold to let me go chase the 20 dollars.

A little more accurate way of looking at our local business might say it's not local exchange. It's local network. We're going to change all the revenues that move over local network facilities. In that case I just bought a $33.50 revenue screen for $16.03 cost of goods sold, a discount of 52 percent. Or if you're in one of our sister divisions, say Gail McGovern's consumer long-distance, she might look at it differently. She might say, Good. For the same $16 that Harry Bennett paid to earn his 23.50 of end user collection, I just had my access reduced by $10. I improved my margin on a $30 toll customer by $10 because I don't have to pay access anymore outside the company. And Harry still has the distance between 16 dollars and 2350 to recover his further costs, which is a 32 percent discount in and of itself. Or if you're Bob Allen you say, I don't care how you all allocate those costs among the divisions, it's all mine. And what I see is a 53.50 cent revenue screen, we saved 30 dollars of toll revenue, we add 2350 of local revenue, and we traded that crushing permanent access cost for a platform cost, plus a little bit of intercity transport cost represented by those yellow dots.

None of this by the way is to say that we can't make some business out of the TSR side of it. On the TSR side, you still have some very attractive long-distance customers, in this case the same $30 toll customer stacked up on top of that local revenue and that local cost. But now you're still paying access, which is why the pink bar goes up as much as it does. And you've lost your opportunity at 3.50 cents for the subscriber line connection recovery. Just another way of showing that your 1350 better off on the right-hand side than you are on the left-hand side. And you know, this can go on for a long time. We could really have fun. How about a 75 dollar toll customer with five dollars of intrastate, intra-LATA toll? Now you move your cost of goods up to 19 dollars but you move your true local collections to 50. I'm dealing with a 64 percent discount, as you see, the higher the toll usage the more pronounced advantage of this platform. And you've got lots of room in there for some sensitivity around the existing costs and prices of the platform.

Having said all that, I want to suggest that none of this is the right way to look at the new AT&T's business. We are more than an all distance business. On top of that all distance stack of revenue we intend to add Internet service, information services, we intend to add anything that requires local connectivity. And we can do it without adding local connectivity costs. It's simply a matter of putting a couple extra pennies on the transport, but the basic connectivity platform stays there in the solid pink. It makes you look at our business in a different way. It's a two-fold business. We're local connectivity and its platform costs and anything and everything that comes after that connectivity.

Clearly there are huge advantages to that kind of business when you use the unbundled platform. It makes that local all distance service much more attractive, makes use indifferent to what happens in access for Internet, gives us an outlet for the new services, let's us work down the pink costs by replacing the RBOC elements with our own switch or our own wireless loop when the economists say so or when we want to differentiate our services. Frankly, all of us, you and the business are probably going to have to work on a different way to keep score. We aren't going to be able to allocate that connectivity cost among our businesses any more decisively and definitively than we've been able to allocate the cost of the local loop for 125 years in the industry.

Look, with all that opportunity, what are the public policy threats to AT&T's going forward business? One I hear most asked about